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9
10 **IN THE UNITED STATES BANKRUPTCY COURT**
11 **FOR THE DISTRICT OF ARIZONA**

12 In re:
13 MORTGAGES LTD., an Arizona
14 corporation,
15 Debtor.

Chapter 11

Case No. 2:08-bk-07465-RJH

**OBJECTION TO THE DISCLOSURE
STATEMENT IN SUPPORT OF THE
DEBTOR'S PLAN OF
REORGANIZATION**

Hearing Date: April 6, 2009
Hearing Time: 3:00 p.m.
Location: 230 N. 1st Avenue,
Courtroom 603, Phoenix, Arizona 85003

16 The Official Committee of Unsecured Creditors of Mortgages Ltd. (the "Unsecured
17 Committee") by and through undersigned counsel in the above-captioned Chapter 11 case
18 hereby files its objection (the "Objection") to the proposed "Mortgages Ltd.'s Disclosure
19 Statement in Support of Its Plan of Reorganization" (the "Disclosure Statement") [Docket
20 No. 1429]. The Unsecured Committee respectfully requests that the Court deny approval
21 of the Disclosure Statement because it does not contain "adequate information" pursuant
22 to 11 U.S.C. §1125(a) and the plan as set forth is unconfirmable. This objection is
23 supported by the following Memorandum of Points and Authorities and the entire record
24 in this case.

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1 MEMORANDUM OF POINTS AND AUTHORITIES

2 **I. Legal Standard for Disclosure Statement Approval.**

3 To be approved, a disclosure statement must offer “adequate information” that
4 would enable a “hypothetical investor of the relevant class to make an informed judgment
5 about the plan.” See *In re Scioto Valley Mortgage Co.*, 88 B.R. 168 (Bankr. S.D. Ohio
6 1988); see also *In re A.C. Williams Co.*, 25 B.R. 173 (Bankr. N.D. Ohio 1982); *In re U.S.*
7 *Brass Corp.*, 194 B.R. 420, 424 (Bankr. E.D. Tex. 1996); *In re Malek* 35 B.R. 443 (Bankr.
8 E.D. Mich. 1983); *In re Metrocraft Publishing Services, Inc.* 39 B.R. 567 (Bankr. N.D.
9 Ga. 1984).

10 **II. The Disclosure Statement contains inadequate information.**

11 **1. The Disclosure Statement contains inadequate information regarding**
12 **the circumstances that gave rise to the filing of the Chapter 11 Petition.**

13 The Disclosure Statement does not provide sufficient information regarding the
14 factors that led to the Debtor’s bankruptcy, including a discussion of the evidence that has
15 been heard by the Court in the course of the settlement hearings that suggested that “the
16 squeaky wheel” Investors were receiving payments other than from the underlying loans
17 that they purportedly invested in. The testimony suggested that as the Debtor’s situation
18 became more dire, certain parties were moved into good loans by the Debtor in exchange
19 for bad loan positions held by the Debtor or other Investors¹. Further, payments were
20 being made to Investors on loans when there probably was not any income coming in
21 from the underlying loans with which to make such payments. By February 2008, the
22 Debtor was deferring funding of certain loans and numerous redemptions/repayment
23 requests by Investors of amounts they had advanced to the Debtor. During the year
24 preceding the filing of Debtor’s bankruptcy, over \$100 Million was dispersed to the
25 Debtor’s principal, Scott Coles, and his affiliates. During this same time period, Scott
26 Coles on behalf of Coles and the Debtor entered into a lease agreement of what appeared
27 to be above market rates for Debtor’s headquarters at 4455 E. Camelback Road, Phoenix,
28

¹ Unless otherwise noted all capitalized terms have the same definition as set forth in the Disclosure Statement and the Investor Committee’s Plan.

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1 Arizona (the "Property") for a five-year period. The Disclosure Statement fails to mention
2 that over 6,000 transactions between Debtor and the Investors took place during the year
3 preceding the filing of the bankruptcy.

4 The Disclosure Statement should discuss the foregoing matters so that, not only the
5 Investors, but all creditors, understand the background and potential claims inherent from
6 the Debtor's prepetition operation, as the operation mutated into a ponzi scheme at some
7 point prepetition.

8 **2. The Disclosure Statement lacks meaningful information regarding**
9 **treatment of Radial Bunny, LLC ("RBLLC") as a secured creditor.**

10 The Disclosure Statement and Plan provide, without any meaningful analysis, for
11 treatment of RBLLC as a "secured creditor with valid and perfected security interest." See
12 Disclosure Statement, page 24. The Disclosure Statement should state that no security
13 agreement was prepared or executed between Debtor and RBLLC. Further, the only
14 financing statements filed with the Secretary of State's office were generic and did not
15 have any after acquired property or future advance provisions contained in them. There is
16 no any mention of how, if at all, RBLLC has a security interest attached to and perfected
17 in, any of the estates REO, late fees, default interest, interest spread, avoidance claims,
18 causes of action or other claims against third parties. Nor is there an explanation as to
19 why RBLLC is granted a priority distribution from the ML. Trust for \$35 Million against
20 the Coles entities claims.

21 **3. The Disclosure Statement's description of Causes of Action and**
22 **Avoidance Claims is insufficient.**

23 The Disclosure Statement properly places certain parties, including SM Coles,
24 Greenburg Traurig, and the Coles Estate on notice that there are likely to be substantial
25 claims against them arising from or relating to their involvement with the Debtor.
26 However, the Disclosure Statement should contain a discussion of potential success of the
27 liquidation trust in the non-bankruptcy litigation, the risks of such litigation, and the
28 source of funding for litigation. Exhibit 7 needs to be supplemented. The potential claims

1 set forth by the Investors Committee in its Amended Disclosure Statement should be
2 included in Debtor's Disclosure Statement. The claims against the various professionals,
3 including Mayer Hoffman and Greenburg Traurig, the SM Cole entities, and insiders
4 should include claims for negligence, breach of contract, breach of fiduciary duty,
5 indemnity, breach of duty of good faith and fair dealing and misrepresentation. Claims
6 against Radical Bunny should also be preserved.

7 **4. The Disclosure Statement fails to discuss the dispute regarding the**
8 **ownership of the fractional interest in notes and deeds of trust.**

9 From the early stages of this case, various parties have asserted that the Estate, not
10 the Investors, is the proper owner of the fractional interest in the notes and deeds of trust.
11 These assertions were based upon different theories, including improper documentation of
12 any assignment or securitization of the fractional interest in notes and deeds of trust and a
13 ponzi scheme analysis. Under the Disclosure Statement and Plan as presently proposed,
14 certain Investors will benefit greatly by virtue of the happenstance of what interest the
15 Debtor had purportedly transferred to them and that such Investors held as of the Petition
16 date. Those Investors who happened to have ended up in a position to claim ownership in
17 paying notes and deeds of trust will receive substantial cash flow while other creditors,
18 including other Investors, are not likely to see any payment for several years, if at all.

19 **5. Failure to disclose Avoidance Claims against RBLLC and the grounds**
20 **for the release of such claims against RBLLC.**

21 During the year preceding the Petition date, RBLLC received almost \$22 Million
22 in cash disbursements from the Debtor which might give rise to claims against RBLLC.
23 The Disclosure Statement provides that on the Effective Date, any potential Avoidance
24 Actions or Causes of Actions held by the Estate against RBLLC shall be deemed settled
25 and resolved upon confirmation of the Plan. The Disclosure Statement fails to contain an
26 analysis of the potential Avoidance Actions or Causes of Actions held by the Estate
27 against RBLLC, including for the cash disbursement and any other transfers of interest to
28 RBLLC that occurred during the two years preceding the filing of the Petition.

1 **6. The Disclosure Statement fails to disclose any source of financing for**
2 **the Plan.**

3 The Disclosure Statement says that the Debtor will obtain exit financing, but does
4 not provide any information about the source, the terms, or details for such financing. The
5 source of such funds, the terms under which the funds will be advanced to the
6 Reorganized Debtor, and any collateral that will be given for such advances should all be
7 disclosed upfront. Further, the terms of the Liquidating Trust Agreement itself should be
8 disclosed.

9 **7. The Disclosure Statement should contain information about who is**
10 **managing the Debtor.**

11 The Disclosure Statement should contain information about the prepetition officers,
12 directors, and the compensation that they received from the Debtor. The Disclosure
13 Statement should disclose the recent resignation of Mr. Feldheim; who is currently
14 managing the Debtor; the prior relationship, if any, of the new directors to either the
15 Debtor or prior directors and officers; and who the Debtor proposes to manage the PLS
16 and the ML Trust. See, §§ 8.1.3 and 8.10.

17 **8. The Disclosure Statement should contain current information**
18 **regarding the value of the REO owned by the Debtor.**

19 Under the Disclosure Statement and Plan, the REO is to be used to fund a portion
20 of the liquidation trust. The current valuation of such property should be disclosed as it
21 reflects on the likelihood of obtaining exit financing, funding of the Reorganized Debtor,
22 funding of the Liquidation Trust and ultimately, the feasibility of the Plan.

23 **9. The Disclosure Statement fails to describe the future management of**
24 **the Debtor and the compensation that would be provided to Debtor's management.**

25 The Disclosure Statement lacks sufficient information as to either the future
26 management of the Reorganized Debtor or the compensation to be paid to such
27 management.
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10. The Disclosure Statement fails to contain a liquidation analysis.

A Chapter 7 liquidation analysis is necessary in order that all creditors, not just those Investors who think they are in loan positions that they are satisfied with, can make a meaningful determination of whether they would be better off under the proposed plan, an alternative plan (e.g. pooling plan), or a Chapter 7 liquidation. In light of the fact that there is likely to be competing Plans, the liquidation analysis should discuss the millions of dollars in additional administrative claims that are likely to be incurred in confirming any Plan, which costs might be avoided under a Chapter 7 liquidation.

11. The Disclosure Statement is based upon an unconfirmable plan and should not be approved.

A court cannot approve a disclosure statement if the plan with which it is related cannot be confirmed as a matter of law. See *In re Beyond.com Corp.* 289 B.R. 138 (Bankr. N.D. Cal., 2003); See also 1125 Collier on Bankruptcy-15th Edition Rev. P 1125.03.

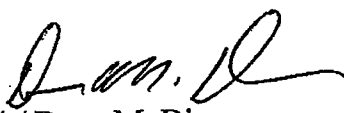
The Plan unfairly discriminates against certain unsecured creditors. As previously discussed, the proposed plan improperly grants ownership interest in the notes and deeds of trust to Investors while at the same time relieving the Investors and RBLLC of any liability for Avoidance Actions and Causes of Action. The Plan also provides RBLLC with a secured interest in the estate's interest in notes and deeds of trust despite the lack of documentation establishing attachment and perfection of any such secured interest.

CONCLUSION

The Unsecured Committee respectfully requests that the Court deny approval of the Disclosure Statement until and unless the foregoing deficiencies are addressed.

RESPECTFULLY SUBMITTED this 30 day of March 2009.

NUSSBAUM & GILLIS, P.C.


By: /s/ Dean M. Dinner
Dean M. Dinner
Attorneys for Official Committee of
Unsecured Creditors

1 ORIGINAL of the foregoing electronically
filed this 30th day of March 2009, with:

2
3 Clerk, United States Bankruptcy Court
4 District of Arizona
5 230 North First Avenue, Suite 101
6 Phoenix, AZ 85003-1706
7 <https://ecf.azb.uscourts.gov>

8 COPY of the foregoing e-mailed
9 this 3rd day of March 2009, to the
10 parties on the attached Service List

11 *W.S. Rineer*

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